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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

LEA MÁRQUEZ PETERSON– CHAIRWOMAN
SANDRA D. KENNEDY
JUSTIN OLSON
ANNA TOVAR
JIM O'CONNOR

Arizona Corporation Commission
DOCKETED
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DOCKETED BY

In the Matter of:

GRAND OAK ENTERPRISES, L.L.C., an Arizona limited liability company,

TARLETON J. KARRY, CRD #2862611, an unmarried man,

Respondents.

DOCKET NO. S-21077A-19-0137

DECISION NO. 78139

OPINION AND ORDER

DATE OF HEARING:	December 21, 2020
PLACE OF HEARING:	Phoenix, Arizona
ADMINISTRATIVE LAW JUDGE:	Brian D. Schneider[1]
APPEARANCES:	Mr. Tarleton J. Karry, *pro per*, and on behalf of Grand Oak Enterprises, L.L.C.; and
	Mr. Ryan J. Millecam, Staff Attorney, Securities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

Procedural History

On June 25, 2019, the Securities Division ("Division") of the Arizona Corporation Commission ("Commission") filed a Notice of Opportunity for Hearing Regarding Proposed Order to Cease and Desist, Order for Restitution, and Order for Administrative Penalties ("Notice") against Grand Oak Enterprises, L.L.C. ("Grand Oak"), and Tarleton J. Karry (collectively "Respondents"), alleging that Respondents have engaged in acts, practices and transactions that constitute violations of the Arizona Securities Act, A.R.S. § 44-1801 et seq. ("Act").

On August 14, 2019, the Respondents filed a Request for Hearing.

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[1] Administrative Law Judge ("ALJ") Brian D. Schneider presided at the hearing and over all pre-hearing matters. ALJ Mark Preny prepared this Recommended Opinion and Order under the direction and supervision of ALJ Schneider, who has reviewed and approved the findings and conclusions contained herein.

On August 15, 2019, by Procedural Order, a pre-hearing conference was scheduled for August 22, 2019.

On August 22, 2019, the pre-hearing conference was held as scheduled. The Division appeared through counsel. The Respondents did not appear. The scheduling of a hearing and other procedural matters were discussed.

On August 23, 2019, the Respondents filed an Answer.

Also on August 23, 2019, by Procedural Order, a hearing in this matter was scheduled to commence on February 4, 2020.

On September 18, 2019, by Procedural Order, the hearing schedule was modified to commence on February 4, 2020, but with the additional hearing date, February 5, 2020, vacated.

On January 28, 2020, the Respondents filed a Motion to Continue Hearing Scheduled for February 4, 2020 ("Motion to Continue").

On January 29, 2020, by Procedural Order, a telephonic pre-hearing conference was scheduled to commence on January 31, 2020.

On January 31, 2020, a telephonic pre-hearing conference was held as scheduled. The Division appeared through counsel and the Respondents appeared *pro per*. Respondents' Motion to Continue was discussed and the Respondents indicated they were trying to obtain legal counsel.

Also on January 31, 2020, by Procedural Order, the hearing scheduled to commence on February 4, 2020, was vacated, and a telephonic pre-hearing conference was scheduled to commence on February 21, 2020, at 10:30 a.m.

On February 3, 2020, the Division filed a Request to Reschedule the February 21, 2020 Telephonic Pre-hearing Conference ("Request to Reschedule"), stating that counsel for the Division had a conflict with the scheduled time.

On February 4, 2020, the Division's Request to Reschedule was granted and the telephonic pre-hearing conference was rescheduled to commence on February 21, 2020, at 1:30 p.m.

On February 21, 2020, the telephonic pre-hearing conference was held as scheduled. The Division appeared through counsel and the Respondents appeared *pro per*. The scheduling of a hearing and other procedural matters were discussed.

On February 25, 2020, by Procedural Order, the hearing in this matter was scheduled to commence on May 26, 2020.

On May 15, 2020, by Procedural Order, a telephonic pre-hearing conference was scheduled to commence on May 19, 2020, to address hearing procedures in light of precautions being undertaken in response to the COVID-19 pandemic.

On May 19, 2020, the telephonic pre-hearing conference was held as scheduled. The Division appeared through counsel and the Respondents appeared *pro per*. The scheduling of a hearing and other procedural matters were discussed.

On May 20, 2020, by Procedural Order, the May 26, 2020 hearing date was vacated and the hearing in this matter was rescheduled to commence on September 29, 2020.

On July 29, 2020, the Division filed a Motion to Continue Hearing, stating that its witness would be unavailable during the scheduled time of the hearing.

On August 11, 2020, by Procedural Order, the hearing in this matter was rescheduled to commence on October 9, 2020.

On September 28, 2020, the Division filed a Request to Schedule Telephonic Pre-Hearing Conference to Discuss Procedure During the Hearing, requesting a telephonic conference to discuss procedure for the hearing.

On September 30, 2020, by Procedural Order, a telephonic pre-hearing conference was scheduled for October 5, 2020.

On October 5, 2020, the telephonic pre-hearing conference was held as scheduled. The Division appeared through counsel and the Respondents appeared *pro per*. Procedural matters for the hearing were discussed.

On October 8, 2020, the Respondents filed a Request to Continue the Hearing ("Request to Continue").

On October 8, 2020, the Division filed a Response to Respondents' Request to Continue.

Also on October 8, 2020, by Procedural Order, a telephonic pre-hearing conference was scheduled for October 8, 2020, to discuss the Respondents' Request.

Later on October 8, 2020, the telephonic pre-hearing conference was held as scheduled. The

Division appeared through counsel. The Respondents failed to appear. The Respondents' Request to Continue was discussed and taken under advisement.

On October 9, 2020, the Respondents filed a document making factual assertions regarding the matter before the Commission.

Also on October 9, 2020, the hearing convened as scheduled. The Division appeared through counsel and the Respondents appeared *pro per*. The Respondents' Request to Continue was discussed and granted. The Respondents were advised that they had until October 16, 2020, to have counsel file a Notice of Appearance on their behalf.

On October 12, 2020, by Procedural Order, a telephonic status conference was scheduled for October 20, 2020.

On October 20, 2020, the telephonic status conference was held as scheduled. The Division appeared through counsel and the Respondents appeared *pro per*. The scheduling of a hearing and other procedural matters were discussed.

On October 21, 2020, by Procedural Order, a hearing in this matter was scheduled for December 21, 2020, and a telephonic status conference was scheduled for November 23, 2020.

On November 23, 2020, the telephonic status conference was held as scheduled. The Division appeared through counsel. The Respondents did not appear. The hearing was confirmed to commence on December 21, 2020.

On December 16, 2020, by Procedural Order, a pre-hearing conference was scheduled for December 17, 2020, to establish the format and associated requirements for the hearing. During the pre-hearing conference, a test hearing would be conducted to test the WebEx videoconferencing equipment to be used at the hearing.

On December 17, 2020, the pre-hearing conference was held as scheduled. The Division appeared through counsel via WebEx videoconferencing. The Respondents appeared *pro per* by telephone. To facilitate compliance with the Commission's COVID-19 protocols at hearing, a test of the WebEx videoconferencing equipment was conducted.

On December 21, 2020, a full public hearing commenced before a duly authorized ALJ of the Commission at its offices in Phoenix, Arizona. The Division appeared through counsel in person. The

Respondents appeared on their own behalf via WebEx videoconferencing. All witnesses appeared via WebEx videoconferencing. At the end of the proceeding, the matter was taken under advisement pending the submission of closing briefs.

On December 30, 2020, by Procedural Order, a schedule for the filing of post-hearing briefs was established whereby the Division would file a Post-Hearing Brief by February 22, 2021, the Respondents would file a Response Brief by April 8, 2021, and the Division would file a Reply Brief by April 23, 2021.

On February 22, 2021, the Division filed its Opening Post-Hearing Brief.

The Respondents did not file a Response Brief by the April 8, 2021 deadline or thereafter.

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DISCUSSION

I. Brief Summary

This is an enforcement action brought against the Respondents for alleged violations of the Arizona Securities Act. The Division alleges that the Respondents offered or sold unregistered securities, while not registered as dealers or salesmen, in violation of A.R.S. §§ 44-1841 and 44-1842. Specifically, the Division alleges that the Respondents violated the Act through the sale of four notes to a former client of Mr. Karry's. The Division also alleges fraud, in violation of A.R.S. § 44-1991(A), against the Respondents regarding these four sales arising from: Mr. Karry's assertion that the investments were secure; Mr. Karry's failure to disclose risks or financial documentation associated with the investments; and Mr. Karry's failure to disclose that he was not registered to sell securities at the time. The Division further requests to amend the Notice to include alleged registration violations against the Respondents involving similar transactions with six other investors.

II. Testimony

KU[2] - Investor

KU testified that she has been a resident of Scottsdale, Arizona, since 2011.[3] KU testified that

[2] The Division requested, and the ALJ allowed, investor KU to be identified by her initials rather than her full name in the Opinion and Order. Tr. at 14-17; Pre-Hearing Conference Tr. at 6 (November 23, 2020).
[3] Tr. at 31.

she holds bachelor's degrees in business and economics, art, and nursing, and an M.B.A.[4] KU testified that she worked as an office manager for a doctor's office in New York from 2002 until 2011.[5] KU testified that she had a net worth over one million dollars when she moved to Arizona in October 2011.[6]

KU testified that she met Mr. Karry in October 2013 when she opened an investment account with UBS Financial Service, Inc. ("UBS"), and Mr. Karry was her financial consultant.[7] KU testified that she moved her account from UBS to Ameriprise Financial Service, Inc. ("Ameriprise"), upon the recommendation of Mr. Karry when he obtained a position at Ameriprise.[8] KU testified that while Mr. Karry was at Ameriprise, he was her financial advisor with whom she met several times to discuss investment opportunities.[9] KU testified that Mr. Karry left Ameriprise in early 2016.[10] KU testified that Mr. Karry told her that he left Ameriprise because "it just didn't work out," and that Mr. Karry did not tell her that he was no longer registered to sell securities.[11]

KU testified that after Mr. Karry left Ameriprise, he contacted her on a regular basis about investment opportunities with construction companies.[12] KU testified that Mr. Karry said he was a middleman obtaining funding for a construction company that would return her money plus dividends.[13] KU testified that Mr. Karry told her that it was a bad time to invest in the stock market, which he believed was going to crash, but investing with him was secure.[14] KU testified that Mr. Karry told her investing with him would be secure, like a CD, and return 8-10% on her investment.[15] KU testified that Mr. Karry told her that her investment would be used by construction companies for building purposes.[16] KU testified that she would have no role with the construction company other than giving money and expecting a return.[17]

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[4] Tr. at 31, 71.
[5] Tr. at 71-72.
[6] Tr. at 72.
[7] Tr. at 32-33.
[8] Tr. at 33.
[9] Tr. at 33-34.
[10] Tr. at 34-35.
[11] Tr. at 35.
[12] Tr. at 36, 39.
[13] Tr. at 36.
[14] Tr. at 36.
[15] Tr. at 37.
[16] Tr. at 38.
[17] Tr. at 38.

KU testified that she received a promissory note from Mr. Karry after she gave him $100,000.[18] The promissory note described the $100,000 as a loan.[19] KU testified that while the promissory note stated an interest rate of "N/A," Mr. Karry told her that the note would pay a fixed $10,000 in interest plus a dividend.[20] KU testified that she received the $10,000 on August 3, 2016, and that she expected to receive her $100,000 investment back on January 16, 2017.[21] KU testified that she invested the $100,000 with Mr. Karry for the sole purpose of receiving the interest on her investment.[22] KU testified that Mr. Karry did not discuss any risks of the investment with her.[23] KU testified that she received a one-time partial principal payment of $50,000 on February 23, 2017.[24]

KU testified that she received a second promissory note from Mr. Karry after giving him a second $100,000.[25] KU testified that she made this investment after Mr. Karry called to discuss investment opportunities with her.[26] KU testified that Mr. Karry told her that she would be paid $8,000 in dividends one month after the investment.[27] KU testified that she received $8,000 in dividends on October 12, 2016, but no other payments from this investment.[28] KU testified that she expected her principal would be returned in late 2017.[29] KU testified that Mr. Karry did not discuss any risks about this investment, but described it as guaranteed that she would get her dividend and her principal back.[30]

KU testified that she received a third promissory note from Mr. Karry after giving him a third $100,000.[31] KU testified that she made this investment after Mr. Karry called to discuss investment opportunities with her.[32] KU testified that Mr. Karry told her that she would be paid an $8,000 dividend one month after the investment.[33] KU testified that Mr. Karry did not discuss any risks about this

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[18] Tr. at 41-43; Exh. S-5.
[19] Tr. at 43; Exh. S-5.
[20] Tr. at 43-44, 96, 116-117; Exh. S-5.
[21] Tr. at 44, 113-114.
[22] Tr. at 44.
[23] Tr. at 44.
[24] Tr. at 44-45, 49, 112.
[25] Tr. at 50, 52; Exh. S-6.
[26] Tr. at 51.
[27] Tr. at 51.
[28] Tr. at 52, 113.
[29] Tr. at 114.
[30] Tr. at 52.
[31] Tr. at 54-55; Exh. S-7.
[32] Tr. at 55.
[33] Tr. at 55, 113.

investment.[34] KU testified that she received the $8,000 dividend but she did not receive anything from her principal investment.[35] KU testified that she expected her principal would be returned in late 2017.[36]

KU testified that Mr. Karry contacted her again about investment opportunities, resulting in her entering a loan agreement for $200,000 with Grand Oak.[37] KU testified that Mr. Karry told her Grand Oak was his private company through which he was going to be conducting business.[38] KU testified that Mr. Karry did not disclose any risks related to his company.[39] KU testified that this investment was different from her previous investments with Mr. Karry in that it was going through Mr. Karry's business and that she would be receiving quarterly dividends instead of one-time dividends.[40] KU testified that she received four quarterly payments of $5,250 each that were paid via four checks from Grand Oak which stated "quarterly dividend."[41] KU testified that she did not receive any repayment of her principal paid to Grand Oak.[42] KU testified that Mr. Karry did not discuss with her any risks in connection with the loan agreement.[43]

KU testified that Mr. Karry presented the investments as being safe and that she trusted him because he was her advisor.[44] KU testified that the interest payments were an important reason for her having purchased the promissory notes.[45] On cross-examination, KU testified that she had refused prior investment opportunities offered to her by Mr. Karry in annuities, an investment that KU did not "believe in."[46] KU testified that she came to think there was a problem with her investments when she did not receive her principal back.[47] KU testified that she contacted Mr. Karry several times asking about the repayment of her investments.[48]

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[34] Tr. at 56.
[35] Tr. at 56-57, 113.
[36] Tr. at 114.
[37] Tr. at 57-60; Exh. S-8.
[38] Tr. at 59.
[39] Tr. at 116.
[40] Tr. at 59.
[41] Tr. at 59, 62-66, 113; Exh. S-9.
[42] Tr. at 59-60.
[43] Tr. at 62.
[44] Tr. at 67.
[45] Tr. at 117.
[46] Tr. at 70-71, 97.
[47] Tr. at 67.
[48] Tr. at 67, 114.

Darius Taylor - Division Investigator

Mr. Taylor testified that he is a special investigator with the Commission's Securities Division with twenty-four years of experience as a Scottsdale police officer.[49] Mr. Taylor testified that he has been assigned to this case since July 2018.[50]

Mr. Taylor testified that Grand Oak was formed on November 9, 2016, pursuant to the Articles of Organization filed with the Commission.[51] Mr. Taylor testified that Grand Oak's Articles of Organization stated that it was member-managed with one member, Mr. Karry, and a place of business located in Scottsdale, Arizona.[52] Mr. Taylor testified that Mr. Karry resided in Scottsdale, Arizona, between 2015 and early 2018.[53] Mr. Taylor testified that Mr. Karry was last registered to sell securities on April 14, 2016, when he was discharged from Ameriprise for failure to meet performance expectations.[54] Mr. Taylor testified that Grand Oak was not registered to sell securities with the Commission from January l, 2016 to December 18, 2019.[55]

Mr. Taylor testified that, pursuant to his investigation, he served the Respondents with a subpoena for the production of documents including business transactions and expenses for Grand Oak, to which he received a response via facsimile on November 9, 2018, from the Respondents' attorney at that time ("Fax Subpoena Response").[56] The Fax Subpoena Response stated that Grand Oak does not sell or offer securities but negotiated a loan agreement and a one-on-one transaction with a specific individual.[57] The Fax Subpoena Response included a copy of the loan agreement with KU, but the Respondents did not produce the three promissory notes with KU, any notes with other investors, or any bank statements.[58]

Mr. Taylor testified that he also received bank records in this matter in response to a subpoena that he served on Northern Trust.[59] Mr. Taylor testified that Grand Oak had a bank account with

49 Tr. at 123-124.
50 Tr. at 124.
51 Tr. at 128; Exh. S-3.
52 Tr. at 128; Exh. S-3.
53 Tr. at 129.
54 Tr. at 131-132, 135; Exhs. S-2, S-4 at 3 of 21.
55 Tr. at 133-134; Exh. S-1.
56 Tr. at 135-137, 150; Exh. S-12.
57 Tr. at 138; Exh. S-12 at ACC000132.
58 Tr. at 139-141; Exh. S-12.
59 Tr. at 141-143; Exhs. S-11a - S-11e, S-13, S-14.

Northern Trust over which Mr. Karry was the only person with signatory authority.[60] Mr. Taylor testified that checks signed by Mr. Karry paid from the Northern Trust account included: two "dividend[s]" paid to John and Laura Svejcar, a "quarterly dividend" paid to KU, a "dividend check" paid to Victor Dubois, and several checks paid to Mr. Karry.[61] Mr. Taylor testified that he attempted to contact the other persons named on the checks but he was unsuccessful in reaching them.[62] Mr. Taylor testified that he received copies of KU's promissory notes from KU's attorney.[63]

Tarleton Karry - Respondent

Mr. Karry testified that KU, based on her own research, rejected numerous investment strategies presented by him and others while he was at UBS.[64] Mr. Karry testified that KU shrewdly negotiated the fee arrangement for the money management and financial planning services that she received at UBS.[65] Mr. Karry testified that KU was very sophisticated in her understanding of fees and the marketplace.[66]

Mr. Karry testified that he brought assets to Ameriprise but he was not an employee of Ameriprise.[67] Mr. Karry testified that he pursued litigation against Ameriprise and KU appeared in that proceeding.[68]

Mr. Karry testified that he told KU in June 2016 that real estate rehabilitation was a new enterprise for him.[69] Mr. Karry testified that KU told him that a condition of loaning him money would be that the money would not be taxable for KU.[70] Mr. Karry testified that the three promissory notes entered with KU were written as she wanted them with no indication that there would be interest that could be taxed.[71] Mr. Karry testified that he and KU had no discussions about the details of the business such as the location of the real estate, business costs, or whether the business was having success at

[60] Tr. at 145; Exh. S-11a.
[61] Tr. at 146-150; Exh. S-14 at NTC000208, NTC000211, NTC000219, NTC000221, NTC000224 - NTC000226.
[62] Tr. at 153.
[63] Tr. at 152-153; Exhs. S-5, S-6, S-7.
[64] Tr. at 156.
[65] Tr. at 156-157.
[66] Tr. at 162-163.
[67] Tr. at 158-159.
[68] Tr. at 159.
[69] Tr. at 159-160.
[70] Tr. at 160.
[71] Tr. at 160.

any point in time.[72] Mr. Karry testified that KU never requested any literature nor did he offer any to her.[73] Mr. Karry testified that he never provided KU with: any financial disclosures of Grand Oak; any financial disclosures for Grand Oak's projects; any due diligence for contractors engaged by Grand Oak; or any disclosures discussing Grand Oak's profits or losses.[74] Mr. Karry testified that his discussions with KU did not become more detailed until he did not pay back one of the notes, at which time he told KU that he needed more time and that he was having issues including problems with contractors and market fluctuations.[75] Mr. Karry testified that KU secured an attorney and they did not speak after that.[76]

Mr. Karry testified that he was the only person operating Grand Oak and the only person with control over Grand Oak's finances.[77] Mr. Karry testified that he had sole control over Grand Oak's bank account.[78]

Mr. Karry testified that Grand Oak negotiated loan agreements with other individuals besides the one with KU that was identified in the Fax Subpoena Response.[79] Mr. Karry testified that these were loans, not equity.[80] Mr. Karry testified that John and Laura Svejcar loaned him around $20,000.[81] Mr. Karry testified that he wrote "dividend" on a March 27, 2017 check to John and Laura Svejcar, which would have been a payment of interest or a dividend as a return on their loan.[82] Mr. Karry testified that he told John and Laura Svejcar about the Grand Oak investment opportunity at a charity event in Denver, Colorado.[83] Mr. Karry testified that he did not remember what documentation John and Laura Svejcar received for their loan or why it was not provided in response to the Division's subpoena.[84] Mr. Karry testified that John and Laura Svejcar received a full return of their investment

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[72] Tr. at 161, 190. On cross-examination, Mr. Karry clarified that while he did not discuss specifics of real estate location with KU, he did tell her it was in Colorado. Tr. at 190-191.
[73] Tr. at 163.
[74] Tr. at 191.
[75] Tr. at 161.
[76] Tr. at 161.
[77] Tr. at 189.
[78] Tr. at 168.
[79] Tr. at 164-165; Exh. S-12.
[80] Tr. at 166.
[81] Tr. at 167.
[82] Tr. at 169-171; Exh. S-12 at NTC000208.
[83] Tr. at 176.
[84] Tr. at 170.

principal.[85]

Mr. Karry testified that he signed a June 27, 2017 check to Victor Dubois and wrote "dividend check" on it.[86] Mr. Karry testified that Mr. Dubois made a loan to Grand Oak.[87] Mr. Karry testified that he could not recall the amount of the loan or whether Mr. Dubois received documentation of the loan.[88] Mr. Karry testified that he and Mr. Dubois were friends and that he told Mr. Dubois about Grand Oak after Mr. Dubois asked him about investment opportunities.[89] Mr. Karry testified that Mr. Dubois invested and received dividends from his investment.[90] Mr. Karry testified that Mr. Dubois received a return of his investment principal in its entirety.[91]

Mr. Karry testified that he signed a November 28, 2017 check to Steven W. Julius and wrote that it was for November 30, 2017, and February 28, 2018 dividends.[92] Mr. Karry testified that this check was for a return on Mr. Julius' investment, not a repayment of principal.[93] Mr. Karry testified that Mr. Julius made a loan to Grand Oak, but Mr. Karry could not recall the amount of the loan.[94] Mr. Karry testified that he told Mr. Julius about Grand Oak at a lunch with mutual friends and that they discussed a return on Mr. Julius' investment.[95] Mr. Karry testified that Mr. Julius received a full return of his investment principal.[96]

Mr. Karry testified that he signed a January 2, 2018 check to Tracy Bergstrom that said it was for an "annual dividend."[97] Mr. Karry testified that Ms. Bergstrom was a friend of his who lent money to Grand Oak after he told her about the opportunity.[98] Mr. Karry testified that he could not recall how much money Ms. Bergstrom lent to Grand Oak.[99] Mr. Karry testified that Ms. Bergstrom did not

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[85] Tr. at 187-188.
[86] Tr. at 171-172; Exh. S-12 at NTC000219.
[87] Tr. at 172.
[88] Tr. at 172-173.
[89] Tr. at 175.
[90] Tr. at 176.
[91] Tr. at 187.
[92] Tr. at 171-172; Exh. S-12 at NTC000232.
[93] Tr. at 175.
[94] Tr. at 174.
[95] Tr. at 174-175.
[96] Tr. at 187-188.
[97] Tr. at 176-177; Exh. S-12 at NTC000237.
[98] Tr. at 177-178.
[99] Tr. at 178.

receive a full return of her investment principal, but Mr. Karry did not know the amount owed to her.[100]

Mr. Karry testified that he signed and wrote "annual divided" on a January 2, 2018 check to Marshall Bergstrom.[101] Mr. Karry testified that Marshall Bergstrom lent money to Grand Oak.[102] Mr. Karry testified that he could not recall the amount of money loaned by Mr. Bergstrom.[103] Mr. Karry testified that Marshall Bergstrom learned about the investment from his mother and that he told Mr. Bergstrom that money lent to Grand Oak was for real estate projects.[104] Mr. Karry testified that the check to Marshall Bergstrom was a return on his investment, not a repayment of principal.[105] Mr. Karry testified that he did not have any documentation for Marshall Bergstrom's loan.[106] Mr. Karry testified that Marshall Bergstrom did not receive a full return of his investment principal.[107]

Mr. Karry testified that he wrote "annual interest [payment]" on a March 1, 2018 check to Dalton Bergstrom.[108] Mr. Karry testified that Dalton Bergstrom did not receive a full return of his investment principal.[109] Mr. Karry testified that he did not know why he wrote interest payment rather than dividend on the March 1, 2018 check, but that this would have been an error.[110] Mr. Karry testified that he believed dividends are paid on business loans while interest is paid on personal loans, and that a loan to Grand Oak is a business loan.[111] Mr. Karry acknowledged that a June 11, 2018 check to Victor Dubois stated that it was for "July 2018 interest payment" even though the check was a payment on a business loan.[112] Mr. Karry testified that he did not know why he wrote interest on the June 11, 2018 check to Victor Dubois, but that he would write "dividend" given the opportunity to write the check now.[113]

Mr. Karry testified that Grand Oak purchased dilapidated real estate to be rehabilitated and

[100] Tr. at 187, 189.
[101] Tr. at 180-181; Exh. S-12 at NTC000242.
[102] Tr. at 181.
[103] Tr. at 181.
[104] Tr. at 181-182.
[105] Tr. at 182.
[106] Tr. at 182.
[107] Tr. at 187-189.
[108] Tr. at 182-183; Exh. S-12 at NTC000245.
[109] Tr. at 188-189.
[110] Tr. at 183-184.
[111] Tr. at 184.
[112] Tr. at 184-185; Exh. S-12 at NTC000248.
[113] Tr. at 186.

resold, but that the company "doesn't operate anymore."[114]

Mr. Karry testified that he negotiated the three promissory notes and one loan agreement with KU.[115] Mr. Karry testified that he did not have "a securities license anywhere anymore" at the time of these four transactions with KU.[116]

Mr. Karry testified that he agreed KU was repaid $50,000 of principal from her $500,000 investment and that KU's testimony regarding interest or dividends she received was only off by a very small amount.[117] Mr. Karry testified that KU stopped receiving payments for reasons including his own poor management, things taking longer and being more expensive than he was promised, conflicts with contractors, and significant increases to original quotes made by general contractors.[118]

III. Legal Argument

A. Motion to Amend the Notice

1. Argument

At the hearing, the Division moved to amend the Notice to conform to the evidence.[119] The Division contended that the evidence at hearing demonstrated that many investors were receiving returns on their investments.[120] The Division argued that the Respondents did not fully comply with the Division's subpoenas, resulting in this information not coming out until the hearing.[121] Mr. Karry objected to the Division's motion and argued that these other persons had not filed complaints.[122] The ALJ instructed the parties to address the motion to amend the Notice in their post-hearing briefs and stated that a ruling would be included in the Recommended Opinion and Order to the Commission.[123]

In its Post-Hearing Brief, the Division specifies that it seeks to conform the Notice to the evidence presented at hearing that the Respondents offered and sold notes to six additional investors. The Division argues that its motion to amend the Notice to conform to the evidence should be granted

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[114] Tr. at 193.
[115] Tr. at 199.
[116] Tr. at 200.
[117] Tr. at 194-195.
[118] Tr. at 196.
[119] Tr. at 202-203.
[120] Tr. at 203.
[121] Tr. at 202, 205, 210-211.
[122] Tr. at 204.
[123] Tr. at 211-212.

pursuant to A.A.C. R14-3-106(E), which gives the Commission or ALJ discretion to allow amendments to formal documents, and Rule 15(b) of the Arizona Rules of Civil Procedure, which allows for a motion to amend the pleadings to conform to the evidence to be made at any time. The Division argues that the issue of the Respondents selling notes to additional investors was tried by the implied consent of the parties. The Division contends that prior to the hearing, the Notice informed the Respondents that the Division was pursuing violations of the Securities Act for the sale of notes and that the Division disclosed potential exhibits showing payments to and from the six additional investors. The Division notes that dividend and interest checks to these six investors were admitted at the hearing without the Respondents objecting to either their admission or the testimony of Mr. Taylor regarding these exhibits.[124] The Division notes that Mr. Karry testified that these persons gave business loans to Grand Oak, the same term he used for KU's investments, and that he agreed that the dividend and interest checks were returns on investments.[125] The Division argues that the Respondents cannot claim surprise from the allegations regarding the additional investors and that they will not be prejudiced by the Commission considering them at this time.

2. Analysis and Conclusion

The Commission's rules allow for the amendment or correction of formal documents and provide that "[f]ormal documents will be liberally construed and defects which do not affect substantial rights of the parties will be disregarded."[126] Motions are to conform insofar as practicable with the Arizona Rules of Civil Procedure.[127] The Arizona Rules of Civil Procedure apply when procedure is not otherwise set forth by law, by the Commission's Rules of Practice and Procedure, or by regulations or orders of the Commission.[128] Rule 15(b) of the Arizona Rules of Civil Procedure permits theories of liability to be treated as if they were raised in the pleadings when they are tried by the express or implied consent of the parties.[129] Amendments under Rule 15(b) allow a case to ultimately be tried on its merits and such amendments should be liberally allowed in the interests of justice.[130] Whether an

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[124] Tr. at 144, 146, 148-149; Exh. S-12.
[125] Tr. at 164-178, 180-185.
[126] A.A.C. R14-3-106(E).
[127] A.A.C. R14-3-106(K).
[128] A.A.C. R14-3-101(A).
[129] *Dietz v. Waller*, 141 Ariz. 107, 112, 685 P.2d 744, 749 (1984).
[130] *Continental Nat'l Bank v. Evans*, 107 Ariz. 378, 381, 489 P.2d 15, 18 (1971).

issue has been tried under Rule 15(b) will depend upon the facts of the case, but the record must have some affirmative showing that the unpleaded issue was reached.[131] A failure to object to the introduction of evidence on the ground that it is not within the issues sufficiently implies consent to try such issues.[132] However, permitting evidence relevant to an existing issue to be admitted without objection does not constitute implied consent to the trial of an issue which has not been raised.[133] It would be error to refuse to allow an amendment of a pleading to conform to proof on the ground that the amendment would be a change in theory.[134] If the amendment would cause prejudice or surprise, it may be properly refused.[135]

Before the hearing, the Respondents received the Division's exhibits for the hearing, which included payments to and from the additional six investors. At the hearing, the Respondents did not object to the admission of copies of checks paid to these investors, nor were any objections raised over the testimony of Mr. Taylor or the questions posed to Mr. Karry regarding these checks. When the Division moved to amend the Notice to conform to the evidence, the Respondents did not assert prejudice or surprise, but objected on the basis that these other investors had not filed complaints.

We find that the issue of the sales of notes to the six additional investors was litigated at the hearing without objection. The Respondents have not demonstrated prejudice or surprise that would defeat the Division's motion to amend the Notice to include these allegations. The Respondents correctly state that none of the additional six investors filed complaints. However, this consideration does not restrict the Division's discretion in bringing an enforcement action. "Our legal system has traditionally accorded wide discretion to criminal prosecutors in the enforcement process . . . and similar considerations have been found applicable to administrative prosecutors as well."[136] Accordingly, the Division's motion to amend the Notice to conform to the evidence presented at hearing that the Respondents offered and sold notes to six additional investors is granted.

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[131] *Hill v. Chubb Life American Ins. Co.*, 182 Ariz. 158, 161, 894 P.2d 701, 704 (1995).
[132] *In re Estate of McCauley*, 101 Ariz. 8, 18, 415 P.2d 431, 441 (1966).
[133] *Magma Copper Co. v. Industrial Comm'n of Arizona*, 139 Ariz. 38, 47, 676 P.2d 1096, 1105 (1983).
[134] *McCauley*, 101 Ariz. at 18, 415 P.2d at 441.
[135] *See Bujanda v. Montgomery Ward & Co. Inc.*, 125 Ariz. 314, 316, 609 P.2d 584, 586 (App. 1980); *Eng v. Stein*, 123 Ariz. 343, 347, 599 P.2d 796, 800 (1979).
[136] *Marshall v. Jerrico, Inc.*, 446 U.S. 238, 248, 100 S. Ct. 1610, 1616, 64 L. Ed. 2d 182 (1980) (internal citations omitted).

B. Classification of the Investments

The Division contends that from 2016 through at least 2018, the Respondents repeatedly offered and sold securities in the form of notes. The Division contends that these notes are securities under both the registration and antifraud provisions of the Act.

1. Registration

The Division argues that pursuant to A.R.S. § 44-1801(27), "any note" is a security. Citing the Arizona Supreme Court in *State v. Tober*, the Division contends that all notes are securities that must be registered with the Commission unless an exemption applies.[137] The Division states that the first three notes sold to KU by Mr. Karry were titled "Promissory Note – Installment Payments with Interest."[138] The Division contends that Mr. Karry identified these notes as investments in conversations with KU, comparing investing in the notes to investing in the stock market or purchasing certificates of deposit.[139] The Division states that these notes provided for payment of interest and a balloon payment after a one-year term.[140] The Division notes that the fourth note, sold by Grand Oak to KU, was titled "Loan Agreement," but it contained almost identical terms as the three notes issued by Mr. Karry, namely the payment of interest and a balloon payment after a one-year term.[141] The Division further notes that the payments on the fourth note were described as "dividends" on Grand Oak's checks to KU.[142] The Division concludes that the four notes sold to KU meet the definition of "any note" and are subject to registration requirements unless an exemption applies.

The Division contends that the investments sold to the additional investors are similar to those sold to KU. The Division notes that Mr. Karry described the investments as business loans; the investments were deposited into Grand Oak's account; and returns on these investments were paid with checks described as dividends or interest payments. The Division concludes that these additional investments were notes subject to registration requirements unless an exemption applies.

The Division argues that, pursuant to A.R.S. § 44-2033, the Respondents bear the burden of

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[137] *State v. Tober*, 173 Ariz. 211, 213, 841 P.2d 206, 208 (1992).
[138] Exhs. S-5, S-6, S-7.
[139] Tr. at 36-37.
[140] Tr. at 43-44, 51, 55, 96, 113-14, 116-117; Exhs. S-5, S-6, S-7.
[141] Tr. at 59, 62-66, 113; Exhs. S-8, S-9.
[142] Exh. S-9.

establishing an exemption from registration. The Division notes that the Respondents did not claim an exemption either in their Answer or at the hearing, and they did not present any evidence of an exemption or a defense.

A note is "[a] written promise by one party (the maker) to pay money to another party (the payee) or to bearer. A note is a two-party negotiable instrument."[143] The three Promissory Notes and Loan Agreement that the Respondents sold to KU meet this definition. The evidence establishes that the investments sold by the Respondents to the additional investors were substantially similar to the investments sold to KU. As such, we find that these investments are also notes.

The Division correctly states the standard applied by the Arizona Supreme Court to determine whether a note is a security for registration purposes, namely that a note is a security unless otherwise exempted by statute. Under A.R.S. § 44-2033, the burden of proof to establish an exemption from registration is borne by the party raising the defense. "Because of the vital public policy underlying the registration requirement, there must be strict compliance with all the requirements of the exemption statute."[144] The Respondents have not argued that an exemption from registration applies to the notes they sold to KU and the additional investors. Therefore, we find the notes sold by the Respondents were securities subject to the registration requirements of the Act.

2. <u>Fraud</u>

The Division contends that the notes are securities under the Act's antifraud provisions. When analyzing a note in terms of whether it is a security for the purposes of the antifraud provisions of the Act, the Arizona Court of Appeals has adopted the "family resemblance" test, which was used under federal securities law by the United States Supreme Court in *Reves v. Ernst & Young*,[145] and adopted in Arizona in *MacCollum v. Perkinson*.[146] The test begins with the presumption that every note is a security.[147] This presumption can be rebutted if a review of four factors establishes a "family resemblance" to a list of instruments that are not securities, or if those factors establish a new category

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[143] NOTE, Black's Law Dictionary (11th ed. 2019).
[144] *State v. Baumann*, 125 Ariz. 404, 411, 610 P.2d 38, 45 (1980).
[145] *Reves v. Ernst & Young*, 494 U.S. 56, 110 S. Ct. 945, 108 L. Ed. 2d 47 (1990).
[146] *MacCollum v. Perkinson*, 185 Ariz. 179, 913 P.2d 1097 (App. 1996).
[147] *Reves*, 494 U.S. at 65, 110 S. Ct. at 951.

of instrument that should be added to the list.[148] This list of notes "that are not securities include[s] the note delivered in consumer financing, the note secured by a mortgage on a home, the short-term note secured by a lien on a small business or some of its assets, the note evidencing a 'character' loan to a bank customer, short-term notes secured by an assignment of accounts receivable, or a note which simply formalizes an open-account debt incurred in the ordinary course of business" as well as "notes evidencing loans by commercial banks for current operations."[149] The four factors considered are: 1) the motivations prompting a reasonable buyer and seller to enter the transaction; 2) the plan of distribution of the instrument to determine if it is an instrument subject to common speculation or investment; 3) the reasonable expectations of the investing public; and 4) whether some risk-reducing factor, such as the existence of another regulatory scheme, would render application of the Securities Act unnecessary.[150] We may also consider the notes in light of the economic realities of the transaction.[151]

The first *Reves* factor is "to assess the motivations that would prompt a reasonable seller and buyer to enter into [the transaction]."[152] Under the first factor, a note is more likely a security "[i]f the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate."[153] Conversely, a note is less likely to be a security "[i]f the note is exchanged to facilitate the purchase and sale of a minor asset or consumer good, to correct for the seller's cash-flow difficulties, or to advance some other commercial or consumer purpose."[154] The Respondents were raising money for their business of financing real estate construction projects.[155] KU purchased notes from the Respondents to receive returns on her principal in the form of interest or dividend payments.[156] The

[148] *Id.* Since both inquiries involve application of the same four-factor test, they "essentially collapse into a single inquiry." *S.E.C. v. Wallenbrock*, 313 F.3d 532, 537 (9th Cir. 2002).
[149] *Reves*, 494 U.S. at 65, 110 S. Ct. at 951 (internal quotations omitted).
[150] *Reves*, 494 U.S. at 66-67, 110 S. Ct. at 951-952; *MacCollum* 185 Ariz. at 187-188, 913 P.2d at 1105-1106.
[151] *Wallenbrock*, 313 F.3d at 538.
[152] *Reves*, 494 U.S. at 66, 110 S. Ct. at 951.
[153] *Reves*, 494 U.S. at 66, 110 S. Ct. at 951-952.
[154] *Reves*, 494 U.S. at 66, 110 S. Ct. at 952.
[155] Tr. at 36, 159-160, 193.
[156] Tr. at 44, 117.

additional investors received interest or dividend payments from their investments.[157] The first *Reves* factor weighs in favor of finding that the notes are securities.

The second *Reves* factor is the plan of distribution. Offers and sales to a broad segment of the public will establish common trading in an instrument.[158] "If notes are sold to a wide range of unsophisticated people, as opposed to a handful of institutional investors, the notes are more likely to be securities."[159] However, the number of investors is not dispositive, but must be weighed against the purchasers' need for the protection of the securities laws.[160] The Respondents were selling notes to individuals, not financial institutions. The record indicates that the Respondents sold notes to investors from at least three states, with Mr. Karry having discussed the investment with John and Laura Svejcar in Colorado,[161] and investors wiring investment money to the Respondents from Nevada,[162] Colorado,[163] and Arizona.[164] The second *Reves* factor weighs in favor of finding that the notes are securities.

The third *Reves* factor is the reasonable expectations of the investing public. The fundamental essence of a security is its character as an investment.[165] When a note seller calls the note an investment, it is generally reasonable for a prospective purchaser to take the offeror at its word, but when note purchasers are expressly put on notice that a note is not an investment, it is usually reasonable to conclude that the investing public would not expect the notes to be securities.[166] The "Promissory Note" and "Loan Agreement" forms identified KU as "lender" and Mr. Karry and/or Grand Oak as "borrower."[167] However, the "Promissory Note" forms did not reflect the economic realities of the transactions which had been described by Mr. Karry as better investments than the stock market or certificates of deposit and were to pay returns not stated in the documents themselves.[168] Mr.

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[157] Tr. at 169-172, 176-177, 180-185; Exh. S-12 at NTC000208, NTC000219, NTC000232, NTC000237, NTC000242, NTC000245, NTC000248.
[158] *Reves*, 494 U.S. at 68, 110 S. Ct. at 953.
[159] *U.S. S.E.C. v. Zada*, 787 F.3d 375, 381 (6th Cir. 2015).
[160] *McNabb v. S.E.C.*, 298 F.3d 1126, 1132 (9th Cir. 2002).
[161] Tr. at 176.
[162] Victor Dubois. (Exh. S-14 at NTC000256).
[163] John and Laura Svejcar (Exh. S-14 at NTC000272).
[164] Steven Julius (Exh. S-14 at NTC000288) and Tracy Bergstrom (Exh. S-14 at NTC000292).
[165] *Reves*, 494 U.S. at 68, 110 S. Ct. at 953.
[166] *Stoiber v. S.E.C.*, 161 F.3d 745, 751 (D.C. Cir. 1998).
[167] Exhs. S-5, S-6, S-7, S-8.
[168] Tr. at 36-37, 43-44, 51, 55, 96, 113, 116-117, 160; Exhs. S-5, S-6, S-7.

Karry described the transactions with the additional investors as loans.[169] None of these additional investors testified as to their expectations and the loan agreement documents for these transactions are not in the record. The third *Reves* factor weighs neither for nor against finding the notes to be securities and we find this factor to be neutral.

The fourth *Reves* factor requires us to look at risk-reducing factors that would diminish the need for protection under the Act, such as the presence of other regulatory schemes, collateral or insurance.[170] The record does not indicate any such protections were available to the investors in this case. The fourth *Reves* factor weighs in favor of finding that the notes are securities.

Under Arizona law, the notes sold by the Respondents are presumed to be securities. Having considered the family resemblances test under *Reves*, we conclude that the notes do not resemble instruments on the *Reves* list, and the evidence does not establish that they should be a category added to that list. Accordingly, we find that the notes are securities subject to the antifraud provisions of the Act.

C. Registration Violations

The Division contends that the Respondents committed registration violations under the Act through the offer and sale of securities four times to KU and at least one time each to the six additional investors.

The record establishes that securities were offered and sold to KU four times and at least once each to the six additional investors. Under A.R.S. § 44-1841, it is unlawful to sell or offer for sale within or from Arizona any securities unless those securities have been registered or are exempt from registration. Under A.R.S. § 44-1842, it is unlawful for any dealer or salesman to sell or offer to sell any securities within or from Arizona unless the dealer or salesman is registered. The securities sold by the Respondents were not registered by the Commission.[171] The Respondents were not registered as securities dealers or salesmen by the Commission at the time the notes were sold.[172] The offers and sales were all made within or from Arizona as Grand Oak had a place of business in Scottsdale,

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[169] Tr. at 166.
[170] *Resolution Trust Corp. v. Stone*, 998 F.2d 1534, 1539 (10th Cir. 1993).
[171] Exh. S-1.
[172] Tr. at 133-137, 150; Exhs. S-1, S-2.

Arizona, and Mr. Karry resided in Scottsdale, Arizona.[173] The record does not establish the presence of any exemptions to the registration requirements. As such, all ten sales of securities violated both A.R.S. § 44-1841 and A.R.S. § 44-1842. Accordingly, we find that Mr. Karry committed ten violations each of A.R.S. § 44-1841 and A.R.S. § 44-1842.

Grand Oak was formed on October 19, 2016, pursuant to the Articles of Organization filed with the Commission.[174] The first two "Promissory Note[s]" between KU and Mr. Karry were executed prior to October 19, 2016, and they did not mention Grand Oak.[175] The third "Promissory Note" between KU and Mr. Karry, executed on October 26, 2016, was virtually identical to the first two notes and again did not mention Grand Oak.[176] KU testified that her fourth investment differed from the first three because it went through Mr. Karry's business, Grand Oak.[177] We find that Grand Oak did not make, participate in or induce the sale of the three "Promissory Note[s]" to KU, and the alleged violations of A.R.S. § 44-1841 and A.R.S. § 44-1842 by Grand Oak are dismissed as to these three securities. The remaining seven securities were sold to KU and the additional investors as "Loan Agreement[s]" with Grand Oak.[178] Regarding these seven sales of securities, Grand Oak committed seven violations each of A.R.S. § 44-1841 and A.R.S. § 44-1842.

D. Fraud Violations

The Division contends that the four sales of securities to KU by the Respondents each constituted a violation of the antifraud provisions of the Securities Act, A.R.S. § 44-1991(A). A.R.S. § 44-1991 provides, in pertinent part:

> It is a fraudulent practice and unlawful for a person, in connection with a transaction or transactions within or from this state involving an offer to sell or buy securities, or a sale or purchase of securities, including securities exempted under section 44-1843 or 44-1843.01 and including

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[173] Tr. at 128-129; Exh. S-3.

[174] Exh. S-3. We note that Mr. Taylor testified that Grand Oak was formed on November 9, 2016, which would be the date that the Articles of Incorporation were filed by the Commission. Tr. at 128; Exh. S-3. Pursuant to A.R.S. § 29-3201(D), a limited liability company is formed when the articles of organization become effective. Here, the articles of organization became effective when they were submitted to the Commission on October 19, 2016. *See* A.R.S. § 29-3207.

[175] Exhs. S-5, S-6.

[176] Exh. S-7.

[177] Tr. at 59.

[178] Tr. at 59, 164-167, 172, 174, 177-178, 181-183; Exh. S-8.

transactions exempted under section 44-1844, 44-1845 or 44-1850, directly or indirectly to do any of the following:

1. Employ any device, scheme or artifice to defraud.
2. Make any untrue statement of material fact, or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.
3. Engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit.

An issuer of securities has an affirmative duty not to mislead potential investors.[179] Under A.R.S. § 44-1991(A)(2), a material fact is one that "would have assumed actual significance in the deliberations of the reasonable buyer."[180] The test does not require an omission or misstatement to actually have been significant to a particular buyer.[181] Materiality will also be found when there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available."[182]

The Division asserts fraud based upon the following misrepresentations and omissions by Mr. Karry: stating that investing with him was better than investing in the stock market, which was going to crash;[183] describing the investments as secure and comparing them to certificates of deposit;[184] failing to disclose any risks associated with the investment, including that it was a start-up company with little operating history;[185] failing to provide any financial documentation that would let an investor assess the investment's ability to generate a large, stable return;[186] and failing to disclose that he was not registered to sell securities or provide investment advisory services after he left Ameriprise.[187] We find that Mr. Karry violated A.R.S. § 44-1991(A)(3) by engaging in a course of business that operated

[179] *Trimble v. Am. Sav. Life Ins. Co.*, 152 Ariz. 548, 553, 733 P.2d 1131, 1136 (App. 1986).
[180] *Aaron v. Fromkin*, 196 Ariz. 224, 227 ¶ 14, 994 P.2d 1039, 1042 (App. 2000).
[181] *Hirsch v. Arizona Corp. Comm'n*, 237 Ariz. 456, 464 ¶ 27, 352 P.3d 925, 933 (App. 2015).
[182] *Caruthers v. Underhill*, 230 Ariz. 513, 524 ¶ 43, 287 P.3d 807, 818 (App. 2012) (internal quotations omitted).
[183] Tr. at 36.
[184] Tr. at 37.
[185] Tr. at 44, 52, 56, 62, 116.
[186] Tr. at 163, 191.
[187] Tr. at 131-132, 135, 200; Exhs. S-2, S-4 at 3 of 21.

as a fraud or deceit by making statements promoting the safety and profitability of the securities he sold to KU without disclosing any risks or financial documentation regarding the investment. We further find that Mr. Karry violated A.R.S. § 44-1991(A)(2) by advising KU about investments without disclosing that he was no longer registered to sell securities or provide investment advisory services, an omission of a material fact necessary to make Mr. Karry's statements not misleading. Accordingly, we find that Mr. Karry committed four violations of A.R.S. § 44-1991 in the four sales of securities to KU. Since Grand Oak did not make, participate in or induce the sale of the three "Promissory Note[s]" to KU, we dismiss the alleged violations of A.R.S. § 44-1991 against Grand Oak as to these three sales. As the fourth security purchased by KU was a "Loan Agreement" with Grand Oak, we find Grand Oak committed one violation of A.R.S. § 44-1991.

E. Control Person Liability

The Division contends that Mr. Karry was a controlling person of Grand Oak and should be jointly and severally liable for Grand Oak's violations of the Act. Under A.R.S. § 44-1999(B), "Every person who, directly or indirectly, controls any person liable for a violation of section 44-1991 or 44-1992 is liable jointly and severally with and to the same extent as the controlled person to any person to whom the controlled person is liable unless the controlling person acted in good faith and did not directly or indirectly induce the act underlying the action." For the purposes of A.R.S. § 44-1999(B), a person may include an individual, corporation or limited liability company.[188] In *E. Vanguard Forex, Ltd. v. Arizona Corp. Comm'n*, the Arizona Court of Appeals interpreted A.R.S. § 44-1999(B) "as imposing presumptive control liability on persons who have the *power* to directly or indirectly control the activities of those persons or entities liable as primary violators of [A.R.S.] §§ 44–1991 and –1992."[189] Therefore, to establish control "the evidence need only show that the person targeted as a controlling person had the legal power, either individually or as part of a control group, to control the activities of the primary violator."[190]

The Division contends that Mr. Karry had the power to manage and control Grand Oak, and did

[188] A.R.S. § 44-1801(16).
[189] *E. Vanguard Forex, Ltd. v. Arizona Corp. Comm'n*, 206 Ariz. 399, 412, 79 P.3d 86, 99 (App. 2003) (Emphasis in original).
[190] *Id.*

manage and control Grand Oak, as demonstrated by: Mr. Karry being the sole member of Grand Oak, a member-managed limited liability company; Mr. Karry being the sole signor on Grand Oak's bank account; and Mr. Karry inducing all acts of Grand Oak including soliciting investors, issuing the notes and paying interest and dividends to investors. The evidence of record establishes that Mr. Karry had the power to control Grand Oak. Mr. Karry bore the burden to prove the affirmative defense of having acted in good faith and not directly or indirectly inducing the act underlying the action. Mr. Karry has failed to meet his burden of proof. We find that Mr. Karry is liable as a control person for the antifraud violation of Grand Oak, pursuant to A.R.S. § 44-1999(B).

F. Remedies

The Division contends that the Respondents should pay restitution and administrative penalties for their violations of the Securities Act. The Division also seeks the entry of a cease and desist order against the Respondents for future violations.

1. Restitution

The Division contends that the Commission should order the Respondents to pay restitution to KU in the amount of $403,000 plus pre-judgment interest for her four investments. The Division states that no restitution is necessary or appropriate for the remaining investors.

The Commission has the authority to order restitution pursuant to A.R.S. § 44-2032.[191] The record establishes that KU paid $500,000 for her four investments and received only $97,000 in return.[192] KU is therefore entitled to restitution in the amount of $403,000. The record does not establish an amount of principal owed to any of the six additional investors. As we have found Mr. Karry to have violated the Act regarding all four of the investments sold to KU, Mr. Karry is liable for restitution to KU in the amount of $403,000 plus interest. We have found Grand Oak did not violate

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[191] A.R.S. § 44-2032 provides, in pertinent part:

> If it appears to the commission, either on complaint or otherwise, that any person has engaged in, is engaging in or is about to engage in any act, practice or transaction that constitutes a violation of this chapter, or any rule or order of the commission under this chapter, the commission, in its discretion may:
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> 1. Issue an order directing such person to cease and desist from engaging in the act, practice or transaction, or doing any other act in furtherance of the act, practice or transaction, and to take appropriate affirmative action within a reasonable period of time, as prescribed by the commission, to correct the conditions resulting from the act, practice or transaction including, without limitation, a requirement to provide restitution as prescribed by rules of the commission. …

[192] Tr. at 41-45, 49-50, 52, 54-60, 62-66, 112-113, 194-195; Exhs. S-5, S-6, S-7, S-8, S-9.

the Act for the first three transactions with KU. Therefore, Grand Oak is liable for restitution to KU only for her fourth investment in the amount of $179,000 plus interest.

2. Administrative Penalties

The Division asserts that the Commission may assess an administrative penalty of up to $5,000 for each violation of the Act. The Division contends that the Respondents committed 20 registration violations and multiple anti-fraud violations. The Division argues that the Commission should order a significant penalty because the Respondents exploited a position of trust with a client after Mr. Karry had been barred from selling securities, and because the Respondents lied in their subpoena response in an attempt to avoid liability for their violations of the Act. The Division recommends that the Respondents pay an administrative penalty of $100,000.

Under A.R.S. § 44-2036(A), the Commission has authority to assess an administrative penalty of no more than $5,000 for each violation committed.[193] The record establishes that Mr. Karry committed violations of A.R.S. §§ 44-1841 and 44-1842 in all ten transactions in this case and violations of A.R.S. § 44-1991 in all four transactions with KU, for a total of 24 violations of the Act. The record establishes that Grand Oak committed violations of A.R.S. §§ 44-1841 and 44-1842 in seven transactions and violated A.R.S. § 44-1991 in one transaction with KU, for a total of 15 violations of the Act. In considering an appropriate amount for administrative penalties, we accept as aggravating factors Mr. Karry's relationship with KU and the Respondents' attempt to conceal their violations of the Act in response to the Division's investigatory subpoena. We find appropriate to order an administrative penalty of $96,000 against Mr. Karry. Additionally, we find appropriate to order an administrative penalty of $60,000 against Grand Oak, of which $4,000 is apportioned to Grand Oak's antifraud violation.

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Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

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[193] A.R.S. § 44-2036 provides, in pertinent part:
A. A person who, in an administrative action, is found to have violated any provision of this chapter or any rule or order of the commission may be assessed an administrative penalty by the commission, after a hearing, in an amount of not to exceed five thousand dollars for each violation.

FINDINGS OF FACT

1. Respondent Tarleton J. Karry resided in Arizona from at least 2015 through mid-2018.[194]

2. Mr. Karry was registered as a securities salesman with the Commission from October 23, 2012 through April 15, 2016.[195] Mr. Karry's registration was associated with UBS Financial Service, Inc., from 2012 through July 31, 2015.[196] Mr. Karry's registration was associated with Ameriprise Financial Service, Inc., from July 31, 2015, until the association was terminated on April 15, 2016.[197] Mr. Karry did not associate with another registered broker after April 15, 2016, and he has not been registered with the Commission as a securities salesman or dealer since then.[198]

3. Respondent Grand Oak Enterprises, L.L.C., is a member-managed Arizona limited liability company located in Scottsdale, Arizona, that was formed on October 19, 2016, with Mr. Karry as the only listed member.[199] Grand Oak has bever been registered by the Commission to sell securities.[200] Grand Oak has never registered securities with the Commission.[201]

4. KU has been a client of Mr. Karry since 2013 when she opened an investment account with UBS and Mr. Karry became her financial advisor.[202] After Mr. Karry left UBS and became associated with Ameriprise on July 31, 2015, he remained KU's financial advisor and he would discuss investment opportunities with her.[203]

5. After Mr. Karry's association with Ameriprise was terminated, he contacted KU regularly about investment opportunities.[204] Mr. Karry did not tell KU that he was no longer registered with the Commission to sell securities.[205] Mr. Karry described himself as a middleman obtaining funding for construction companies that would pay returns on KU's investments.[206] Mr. Karry

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[194] Tr. at 129; Notice at ¶ 2; Answer at ¶ 2.
[195] Tr. at 134-135; Exh. S-2.
[196] Exh. S-4 at 3-4.
[197] Exh. S-4 at 3.
[198] Tr. at 135; Exhs. S-2, S-4.
[199] Tr. at 127-128; Exh. S-3.
[200] Tr. at 132-134; Exh. S-1.
[201] Tr. at 134; Exh. S-1.
[202] Tr. at 32-33; Exh. S-15 at 1.
[203] Tr. at 33-34; Exh. S-15 at 2.
[204] Tr. at 36, 39.
[205] Tr. at 35.
[206] Tr. at 36.

presented these investments as safe and secure, like a certificate of deposit, and preferable to the stock market which he believed would crash.[207] Mr. Karry did not tell KU about any risks to these investments or provide her with any financial disclosures pertaining to the investments.[208]

6. KU made four investments based on the representations of Mr. Karry:

- On June 27, 2016, KU invested $100,000 with Mr. Karry and received a document titled "Promissory Note – Installment Payments with Interest."[209] The note identified Mr. Karry as the borrower and KU as the lender.[210] Under the terms of the note, Mr. Karry was to pay back the loan in one payment of not less than $100,000 on January 16, 2017.[211] The note did not state a rate of interest, but Mr. Karry told KU that she would be paid a fixed $10,000 in interest.[212]
- On September 12, 2016, KU invested $100,000 with Mr. Karry and again received a document titled "Promissory Note – Installment Payments with Interest" that identified Mr. Karry as the borrower and KU as the lender.[213] The note stated that KU would receive one payment in full on September 26, 2017, but the note did not state a rate of interest or the amount of this payment.[214] Mr. Karry told KU that she would receive her principal back and, in one month of making the investment, she would receive $8,000 in dividends.[215]
- On October 26, 2016, KU invested another $100,000 with Mr. Karry and yet again received a document titled "Promissory Note – Installment Payments with Interest" that identified Mr. Karry as the borrower and KU as the lender.[216] Under the terms of the note, Mr. Karry was to pay back the loan in one payment of not less than $100,000 on November 9, 2017.[217] The note did not state a rate

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[207] Tr. at 36-37, 67.
[208] Tr. at 44, 52, 56, 62, 191.
[209] Tr. at 41-43; Exh. S-5.
[210] Exh. S-5.
[211] Exh. S-5.
[212] Tr. at 43-44, 96, 116-117; Exh. S-5.
[213] Tr. at 50, 52; Exh. S-6.
[214] Exh. S-6.
[215] Tr. at 51-52.
[216] Tr. at 54-55; Exh. S-7.
[217] Exh. S-7.

of interest, but Mr. Karry told KU that she would be paid an $8,000 dividend one month after making the investment.[218]

- On February 10, 2017, KU invested $200,000 with Grand Oak and received a document titled "Loan Agreement" that identified Grand Oak as the borrower and KU as the lender.[219] Pursuant to the "Loan Agreement," Grand Oak was to pay KU quarterly interest payments of $5,250 and repay all outstanding principal and interest on February 22, 2018.[220]

7. On her first investment, KU received a $10,000 interest payment from Mr. Karry and a $50,000 partial return of her principal.[221] On her second investment, KU received only an $8,000 interest payment from Mr. Karry.[222] KU received only an $8,000 interest payment from Mr. Karry for her third investment.[223] On her fourth investment, KU received only four $5,250 checks from Grand Oak, each signed by Mr. Karry and described as a "dividend" on the check.[224]

8. Grand Oak and Mr. Karry sold loan agreements like the one sold to KU to at least six other investors.[225] Grand Oak and Mr. Karry wrote checks to these investors that were described as dividend or interest payments.[226] The Respondents did not disclose these other investors in response to a Division subpoena, falsely claiming that they sold only the one loan agreement to KU.[227]

9. These findings of fact are based upon the Discussion above, and those findings are also incorporated herein.

CONCLUSIONS OF LAW

1. The Commission has jurisdiction of this matter pursuant to Article XV of the Arizona Constitution and A.R.S. § 44-1801, *et. seq.*

2. The findings contained in the Discussion above are incorporated herein.

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[218] Tr. at 55, 113; Exh. S-7.
[219] Tr. at 57-58, 60; Exh. S-8
[220] Exh. S-8.
[221] Tr. at 37, 43-44, 113.
[222] Tr. at 52, 113.
[223] Tr. at 56-57, 113.
[224] Tr. at 59, 62-66, 113; Exh. S-9.
[225] Tr. at 164-165, 167, 172, 174, 178, 181, 188-189.
[226] Tr. at 169-172, 176-177, 180-181, 182-183; Exh. S-12 at NTC000208, NTC000219, NTC000232, NTC000237, NTC000242, NTC000245.
[227] Tr. at 135-141; Exh. S-12.

3. Within or from Arizona, Respondents Tarleton J. Karry and Grand Oak offered and sold securities within the meaning of A.R.S. § 44-1801.

4. Respondents Tarleton J. Karry and Grand Oak failed to meet their burden of proof pursuant to A.R.S. § 44-2033 to establish that the securities offered and sold were exempt from regulation under the Act.

5. Respondents Tarleton J. Karry and Grand Oak violated A.R.S. § 44-1841 by offering and selling securities that were neither registered nor exempt from registration.

6. Respondents Tarleton J. Karry and Grand Oak violated A.R.S. § 44-1842 by offering and selling securities while not being registered as dealers or salesmen.

7. Respondents Tarleton J. Karry and Grand Oak committed fraud in the offer and sale of securities, in violation of A.R.S. § 44-1991, in the manner set forth hereinabove.

8. Respondent Tarleton J. Karry directly or indirectly controlled Grand Oak, within the meaning of A.R.S. § 44-1999, and he is jointly and severally liable with Grand Oak for Grand Oak's violation of A.R.S. § 44-1991.

9. Respondents Tarleton J. Karry's and Grand Oak's conduct is grounds for a cease and desist order pursuant to A.R.S. § 44-2032.

10. Respondents Tarleton J. Karry's and Grand Oak's conduct is grounds for an order of restitution pursuant to A.R.S. § 44-2032 and A.A.C. R14-4-308.

11. Respondents Tarleton J. Karry's and Grand Oak's conduct is grounds to order administrative penalties pursuant to A.R.S. § 44-2036.

ORDER

IT IS THEREFORE ORDERED that pursuant to the authority granted to the Commission under A.R.S. § 44-2032, Respondents Tarleton J. Karry and Grand Oak Enterprises, L.L.C. shall cease and desist from their actions, as described above, in violation of A.R.S. §§ 44-1841, 44-1842 and 44-1991.

IT IS FURTHER ORDERED that pursuant to the authority granted to the Commission under A.R.S. § 44-2032, Respondent Tarleton J. Karry shall make restitution in the amount of $403,000, payable to the Arizona Corporation Commission within 90 days of the effective date of this Decision. Such restitution shall be made pursuant to A.A.C. R14-4-308 subject to legal setoffs by the

Respondents and confirmed by the Director of Securities.

IT IS FURTHER ORDERED that pursuant to the authority granted to the Commission under A.R.S. § 44-2032, Respondent Grand Oak Enterprises, L.L.C. shall make restitution, jointly and severally with Respondent Tarleton J. Karry, in the amount of $179,000, payable to the Arizona Corporation Commission within 90 days of the effective date of this Decision. Such restitution shall be made pursuant to A.A.C. R14-4-308 subject to legal setoffs by the Respondents and confirmed by the Director of Securities.

IT IS FURTHER ORDERED that all ordered restitution payments shall be deposited into an interest-bearing account(s), if appropriate, until distributions are made.

IT IS FURTHER ORDERED that the ordered restitution shall bear interest at the rate of the lesser of 10 percent *per annum*, or at a rate *per annum* that is equal to one percent plus the prime rate as published by the Board of Governors of the Federal Reserve System of Statistical Release H.15, or any publication that may supersede it on the date that the judgment is entered.

IT IS FURTHER ORDERED that the Commission shall disburse the restitution funds to the investor shown on the records of the Commission. Any restitution funds that the Commission cannot disburse to an investor because the investor is deceased, or that the Commission determines it is unable to or cannot feasibly disburse, shall be transferred to the general fund of the State of Arizona.

IT IS FURTHER ORDERED that pursuant to the authority granted to the Commission under A.R.S. § 44-2036, Respondent Grand Oak Enterprises, L.L.C. shall pay to the State of Arizona administrative penalties in the amount of $60,000, of which $4,000 is for a violation of A.R.S. § 44-1991, as a result of the conduct set forth in the Findings of Fact and Conclusions of Law.

IT IS FURTHER ORDERED that pursuant to the authority granted to the Commission under A.R.S. § 44-2036, Respondent Tarleton J. Karry shall pay to the State of Arizona administrative penalties in the amount of $96,000 as a result of the conduct set forth in the Findings of Fact and Conclusions of Law. Respondent Tarleton J. Karry shall also pay jointly and severally with Grand Oak Enterprises, L.L.C. its administrative penalty of $4,000 for its violation of A.R.S. § 44-1991, pursuant to A.R.S. § 44-1999(B).

IT IS FURTHER ORDERED that all administrative penalties shall be payable by either cashier's check or money order payable to "the State of Arizona" and presented to the Arizona Corporation Commission for deposit in the general fund for the State of Arizona.

IT IS FURTHER ORDERED that the payment obligations for these administrative penalties shall be subordinate to the restitution obligations ordered herein and shall become immediately due and payable only after restitution payments have been paid in full or upon Respondents' default with respect to Respondents' restitution obligations.

IT IS FURTHER ORDERED that if Respondents fail to pay the administrative penalties ordered hereinabove, any outstanding balance plus interest, at the rate of the lesser of ten percent *per annum* or at a rate *per annum* that is equal to one percent plus the prime rate as published by the Board of Governors of the Federal Reserve System in Statistical Release H.15 or any publication that may supersede it on the date that the judgment is entered, may be deemed in default and shall be immediately due and payable, without further notice.

IT IS FURTHER ORDERED that if any of the Respondents fail to comply with this Order, any outstanding balance shall be in default and shall be immediately due and payable without notice or demand. The acceptance of any partial or late payment by the Commission is not a waiver of default by the Commission.

IT IS FURTHER ORDERED that default shall render Respondents liable to the Commission for its cost of collection and interest at the maximum legal rate.

IT IS FURTHER ORDERED that if any of the Respondents fail to comply with this Order, the Commission may bring further legal proceedings against the Respondent(s) including application to the Superior Court for an order of contempt.

IT IS FURTHER ORDERED that if any of the Respondents fail to comply with this Order, the Commission may bring further legal proceedings against the Respondent(s) including application to the Superior Court for an order of contempt.

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IT IS FURTHER ORDERED that pursuant to A.R.S. § 44-1974, upon application the Commission may grant a rehearing of this Order. The application must be received by the Commission at its offices within twenty (20) calendar days after entry of this Order. Unless otherwise ordered, filing an application for rehearing does not stay this Order. If the Commission does not grant a rehearing within twenty (20) calendar days after filing the application, the application is considered to be denied. No additional notice will be given of such denial.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRWOMAN MÁRQUEZ PETERSON

COMMISSIONER KENNEDY

Anna Tovar

COMMISSIONER OLSON

COMMISSIONER TOVAR

COMMISSIONER O'CONNOR

IN WITNESS WHEREOF, I, MATTHEW J. NEUBERT, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 28 day of July 2021.

MATTHEW J. NEUBERT
EXECUTIVE DIRECTOR

DISSENT ______________________

DISSENT ______________________

SERVICE LIST FOR: GRAND OAK ENTERPRISES, L.L.C. and TARLETON J. KARRY

DOCKET NO.: S-21077A-19-0137

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